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August 18, 2008

**AGENDA ITEM 4**

**TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE**

- I. SUBJECT:** Real Estate – Revision of Policy on International Equity Real Estate
- II. PROGRAM:** Real Estate
- III. RECOMMENDATION:** Recommend to the Investment Committee approval of the revised Statement of Investment Policy for International Equity Real Estate

**IV. ANALYSIS:**

On September 10, 2007, the Investment Committee (“Committee”) approved the Strategic Plan for CalPERS Real Estate portfolio, which contained a number of findings and recommendations to be implemented for the Fund’s real estate investments in the coming 5 to 10 years. One of the Plan’s recommendations was to invest in international markets including emerging markets. The Plan also recommended that staff clarify the framework for investing in emerging markets after the replacement of the permissible countries list with the new CalPERS Emerging Equity Markets Principles.

With this policy revision, staff recommends a framework for global investing which divides the global real estate universe into regions for purposes of delineating the permissibility and diversification of the portfolio. Attachment 1 illustrates how the current real estate portfolio fits within these guidelines.

Further, staff recommends the adoption of guidelines for emerging markets investments which include adherence to the “CalPERS Emerging Equity Markets Principles” as well as the “United Nations Principles for Responsible Investment”.

The proposed policy included as Attachment 2 differs from existing policy substantively in four key areas. First, the proposed policy sets forth a geographical division of the real estate universe in terms of three spheres; Developed Markets, Emerging Markets, and Frontier Markets. This division contrasts with existing policy in that existing policy utilized the permissible or non-

permissible countries list framework where only investments in permissible countries were allowed. The proposed policy sets forth ranges and limitations for real estate investments in each of the three spheres. Secondly, the proposed policy sets forth specific geographical diversification ranges, a recommendation of the Strategic Plan. Existing policy utilized only a general diversification statement. Third, the proposed policy clarifies that Frontier Markets investments require Committee approval except for minimal percentages within commingled funds. Lastly, the proposed policy clarifies that the CalPERS Emerging Equity Markets Principles and the UN Principles for Responsible Investing will be a guide to investments in emerging markets in the real estate portfolio.

It should be noted that the Committee allowed four exceptions to existing policy. One exception allowed up to 25% of a commingled fund to be invested in non-permissible countries (China and Eastern Europe) and the others were fund specific exceptions.

Non-substantive changes to the existing policy are comprised of deletions for consolidation purposes and for transfer of process and procedural language to the Staff Internal Procedural Manual. Please note that deletions to the Performance Objectives and Benchmark sections reflect the Policy Subcommittee's approval of Agenda Item 6 in June 2008 of the revised Equity Real Estate Policy, Performance Objective section which included new benchmarks for the entire real estate portfolio.

The proposed policy has not been revised to conform to the approved new investment policy template. Staff wishes to ensure that substantive changes proposed herein will not be confused with proposed changes being presented at the October Policy Subcommittee meeting, in connection with the overarching Policy Review and Consolidation Project. The revised policies to be presented in October will utilize the new investment policy template.

PCA Real Estate Advisors, Inc. letter regarding the revised geographic guidelines is attached in Attachment 3.

## **V. STRATEGIC PLAN:**

This item supports Goal VIII to manage the risks and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and, second to minimize and stabilize contributions.

## **VI. RESULTS/COSTS:**

There are no costs associated with this item.

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